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May 30, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

Re: *GTE Corp. and Bell Atlantic Corp., CC Docket No. 98-184*

Dear Ms. Salas:

On behalf of AT&T Corp. ("AT&T"), this *ex parte* letter responds to the *Ex Parte* Declaration of Mark E. Gaumond ("Gaumond Dec.") filed by Bell Atlantic Corp. and GTE Corp. (collectively "Applicants") on May 18, 2000 in support of their proposal regarding GTE's interLATA assets. As explained below, the assertions in that Declaration provide no support for Applicants' claim that their proposal would be lawful. Indeed, each of Mr. Gaumond's assertions either (a) is immaterial to the legal question under Section 3(1) of the Communications Act, or (b) simply assumes Applicants' desired conclusion: that Applicants will not possess an equity interest (or its equivalent) of greater than 10% in, or have control over, Genuity.

As an initial matter, Mr. Gaumond's Declaration does not dispute AT&T's showing that, under established accounting principles, Applicants' "option" would generally be treated the same as common stock for purposes of calculating fully diluted earnings per share.¹ This is significant because Applicants have themselves acknowledged that instruments that entitle their holder to share in a company's earnings are "equity interests."² Basic accounting principles thus reflect the economic reality that an option allows its holder the right to participate in a company's earnings.

¹ Opposition of AT&T Corp. to Applicants' Revised Proposal Regarding GTE's InterLATA Operations, at 9 (May 5, 2000) ("AT&T Opp.").

² Supplemental Filing of Bell Atlantic and GTE, at 35 n.21 (Jan. 27, 2000) ("BA-GTE Supp."); Declaration of Professor Ronald J. Gilson, ¶ 18 (Feb. 22, 2000) ("Gilson Dec.").

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Indeed, Applicants have effectively conceded this point. Applicants argue only that this accounting principle would not apply until after Applicants removed the “contingency” from their “option” – *i.e.*, obtained section 271 authorizations for 50% of Bell Atlantic states.³ But by so arguing Applicants acknowledge that this accounting principle would apply – and their “option” would be treated as the equivalent of common stock – during much of the period before which Applicants would have obtained the necessary section 271 authorizations (*i.e.*, under their proposal, after they obtain approval for two additional states and pass the 50% mark but before they obtain complete relief for all other necessary states). Thus, insofar as accounting treatment is relevant, it indicates that in this respect Applicants’ “option” would be treated like common stock before Applicants may permissibly own equity interests of this magnitude in a long-distance carrier.

Accordingly, Mr. Gaumond instead concentrates on other aspects of the accounting treatment of the “option,” which he claims support Applicants’ position. He claims that Bell Atlantic-GTE’s and Genuity’s proposed accounting for the interest Applicants would hold in Genuity demonstrates that the “option” is not an equity interest. Neither proposed treatment does so.

Bell Atlantic-GTE Accounting. Mr. Gaumond says that Applicants would not be reflecting Genuity’s earnings on their financial statements and therefore this treatment is consistent with Applicants’ claim that they would hold less than a 10% economic interest in Genuity. Gaumond Dec. ¶ 4. In making these arguments, however, Mr. Gaumond acknowledges that Applicants could not use this “cost” method of accounting if Applicants would control Genuity. Thus, Mr. Gaumond is simply assuming his conclusion – that there will be no such control. As AT&T as repeatedly demonstrated, that is not the case.⁴ Mr. Gaumond’s Declaration adds nothing to this proceeding on this issue because it provides no independent analysis of whether Applicants would in fact control Genuity.

Mr. Gaumond’s Discussion also discusses the type of *pro forma* footnote disclosure Applicants would provide in Bell Atlantic-GTE’s combined financial statements, and provides an illustration of such treatment. See Gaumond Dec. ¶ 2 & Exh. A. Mr. Gaumond asserts that this type of footnote would support Applicants’ position because it would state that Applicants hold less than a 10% “voting equity.” The fact that the footnote uses the term “voting equity,” however, makes clear that Mr. Gaumond is only talking about a subset of “equity.” No one in this proceeding has ever disputed that, under their proposal, Applicants would initially obtain only a 9.5% vote in matters that are put to a shareholders’ vote (subject, of course, to the veto

³ Response of Bell Atlantic and GTE in Support of their Further Submissions, at 23 (May 9, 2000).

⁴ See, *e.g.*, AT&T Opp. at 26-29; AT&T March 22, 2000 *Ex Parte*, at 19-21.

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rights provided through the so-called "investor safeguards"). The relevant question for Section 3(1) of the Communications Act is not whether the conversion right is "voting equity," but whether it is "equity (or the equivalent thereof)." (By contrast, Section 273(d)(8) of the Communications Act sets forth a definition of "affiliate" that is specific to Section 273 and that *does* use the narrower term "voting equity," showing that Congress recognized the distinction). And the detailed description in the footnote of the "conversion right" makes plain that the "conversion right" is in fact an equity interest under the well-established securities, corporate, and bankruptcy law principles that AT&T has previously cited.⁵

Genuity Accounting. Mr. Gaumond's discussion of Genuity Accounting likewise does nothing to advance Applicants' position. Mr. Gaumond's central argument is to point to the balance sheet/*pro forma* capitilization table that Genuity would file, which he says would show that the Class A shares represent a right to 90.5% of the total shareholder's equity and that the Class B shares represent a right to only 9.5%. Gaumond Dec. ¶ 5 & Exh. B. While the hypothetical balance sheet/*pro forma* capitilization table Mr. Gaumond has constructed may accurately indicate Genuity's accounting intentions, it in no way supports Applicants' proposal.

Mr. Gaumond bases his analysis on the fact that the balance sheet/*pro forma* capitilization table Genuity would file would list the Class A shares as having a value of \$90,500,000 and the Class B shares as having a value of \$9,500,000. Given these values, he notes that the Class B shares are 9.5% of the sum of the combined value of the Class A and Class B shares. Gaumond Dec. ¶ 5. But the relative values assigned to the Class A and B shares are derived not from the real economic value of the shares, but from the "par values" Mr. Gaumond says Applicants would pick – \$10 per share.

It is textbook law that par values are simply arbitrary numbers that a company assigns to its shares. Par value is "[t]he face or stated value of a share of stock or bond. In the case of a common share, par means an arbitrary or nominal value assigned to the share by the issuing company. . . . Par value has little significance so far as market value of common stock is concerned." Black's Law Dictionary (6th Ed 1990). *See also* Fletcher Cyclopedia of Corporations § 5080.40 (1995). That is why states have largely abandoned use of the "par value" concept and why "modern credit investigat[ors] . . . do not rely on corporate balance sheets." *Id.*

The arbitrariness of the use of par values in this manner is highlighted by Mr. Gaumond's example. Genuity's recent Registration Statement lists the par value of the Class A shares as \$0.01, *see* Genuity Inc. S-1 (May 24, 2000), Exh. 4.1, not the \$10 Mr. Gaumond records in his hypothetical. Mr. Gaumond clearly chose to not use the actual par value picked by GTE because

⁵ *See, e.g.,* AT&T Opp. at 8-25; AT&T March 22, 2000 *Ex Parte*, at 6-19.

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it would make plain that it is an arbitrary number that bears no relationship to the real value of the shares.

Thus, Mr. Gaumond's claim that Applicants would hold less than a 10% equity interest in Genuity is ultimately based on nothing more than the fact that Applicants will themselves arbitrarily assign the Class A and Class B shares the same par value. If Applicants were instead required to pick par values reflecting the relative economic values of the two shares, the balance sheet would list an aggregate value of the Class B shares well in excess of the Class A shares. Likewise, if Genuity sold the Class B shares to a third party rather than issuing them directly to Applicants, the Stockholders' Equity reflected on the balance sheet would be increased by the real economic value of the Class B shares because the proceeds of the sale would be accounted for as additional paid-in-capital.

Mr. Gaumond's argument is also based on a flawed premise. Mr. Gaumond notes that "total stockholders' equity . . . represents the residual interest in a company's assets (after deducting liabilities) on which shareholders have a claim" and "the extent to which individual shareholders have a claim turns on their relative ownership interests." Gaumond Dec. ¶ 6.⁶ The relevant statutory term – "equity (or equivalent thereof)," however, is much broader than "stockholders' equity." Indeed, Applicants have conceded that certain debt instruments that give a right to share of earnings are "equity,"⁷ but these and other types of equity interests would not be accounted for as "stockholder equity." Thus, it is simply not the case those interests that would be listed as "Stockholders' Equity" represent the full spectrum of equity claims that one can have on the assets of a company. And the relative value of the various equity interests issued by a company are not determined by the "par value" assigned to them but how the market values

⁶ This statement is also wrong for reasons discussed above. As Mr. Gaumond concedes, the "total stockholders' equity" is determined in part by the par values of the Class A and B shares. As discussed above, these par values have no economic significance. Gaumond Dec. ¶ 6. What determines the real "residual interest in a company" is the market value of its assets, not arbitrary values recorded on its books.

⁷ BA-GTE Supp. at 35 n.21; Gilson Dec. ¶ 18.

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the bundle of rights that inhere in those interests. Here, that means that the Class B shares would represent approximately 80% of the equity of Genuity and the Class A shares only approximately 20%.⁸

Yours truly,


Peter D. Keisler

cc: Dorothy Attwood
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⁸ AT&T Opp. at 2, 6, 10, 15-16.